



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

19 Sep 1995

MEMORANDUM FOR DISTRIBUTION

Subj : ASSESSMENT OF PENALTIES AND INTEREST FOR UNALLOWABLE COSTS

Encl: (1) DODIG memo of 29 Aug 95; same subject

Enclosure (1) is forwarded for your information. We recommend that you distribute this information to all contract administration offices and administrative contracting officers.

Elliott B. Branch
Elliott B. Branch
Executive Director
Acquisition & Business
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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2854



**Analysis
and Followup**

AUG 29 1995

MEMORANDUM FOR DIRECTOR OF PROCUREMENT POLICY,
OFFICE OF THE ASSISTANT SECRETARY OF THE NAVY
(RESEARCH, DEVELOPMENT, AND ACQUISITION)

**SUBJECT: Assessment of Penalties and Interest for
Unallowable Costs**

During recent contract audit followup reviews conducted by our office, we found confusion about the assessment of penalties and interest against contractors which include unallowable indirect costs in final indirect cost rate proposals or in the final statement of costs incurred under fixed-price incentive contracts.

The enclosed memorandums discuss and provide policy guidance on this subject. Enclosure 1 is our request for policy clarification from the Director of Defense Procurement (DDP), and Enclosure 2 provides the DDP response. We recommend that you distribute this information to all contract administration offices and administrative contracting officers.

Michael A. DiRenzo
Director
Contract Audit Followup

Enclosures

ENCLOSURE(1)



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2854



FEB 22 1995

Analysis
and **Followup**

MEMORANDUM FOR DEPUTY DIRECTOR, COST, PRICING AND FINANCE
OFFICE OF THE DIRECTOR, DEFENSE **PROCUREMENT**

SUBJECT: **Assessment of Penalties and Interest for
Unallowable Costs**

Our **office is** planning to conduct a special **review** of overhead settlements and the assessment of penalties and interest for unallowable costs. Preliminary **indications** from our routine contract **audit followup field** reviews are that confusion exists **in this** area. Before beginning the review, we would **like** your **advice** on the proper procedures for assessing penalties and **interest in accordance with DFARS 231.70--PENALTIES FOR UNALLOWABLE COSTS**, and other provisions of law and regulation. We have the following specific questions:

1. Under **DFARS 231.7002-1(a) (1)**, are both (i) and (ii) considered to be penalties?
2. Can the **ACO** waive just the interest portion of the penalty **in** accordance with Subpart 231.7002-5? Conversely, if the **ACO** waives the **penalty prescribed in (i)**, can interest **still** be assessed under (ii) **if it is** determined a portion of the disallowed costs has been **paid**?
3. We would like clarification on the relationship between interest on the paid portion of disallowed costs under **DFARS 231.70** versus interest on overpayments to contractors as a result of **CAS 405** noncompliances. The interest provision at 231.7002-1(a) (1) (ii) and its computation at 231.7002-4(c) require that interest on the paid portion of disallowed costs be calculated from the date of overpayment to the date of the demand letter for payment of the penalty.
 - (a) How do **these requirements** relate to interest provisions in **P.L. 100-679** and **FAR 30.602-2(c) (2)**, **which require** that interest on increased costs paid to a contractor as a result of a **CAS** noncompliance be computed from the date of overpayment to the time a contract adjustment is effected?
 - (b) Suppose **DCAA** cites the contractor for noncompliance with **CAS 405** for failure to identify and exclude unallowable costs from proposals, billings, or

Enclosure 1

claims, and the ACO follows the procedures under 30.602-2. Would this conflict with the requirements of DFARS 231.70? Should the ACO follow both?

(c) Would the penalty and interest on the paid portion of disallowed costs be assessed in addition to interest on the increased costs paid as a result of a CAS 405 noncompliance?

4. Under 231.7002-3(c), should a **final decision** and demand for payment be **issued** even **if** the contractor agrees **with** the amount of the penalty?

5. If the ACO has not issued a demand letter for the penalty, can interest still be assessed on the paid portion of disallowed costs under 231.7002-3(c), which requires that interest be computed from the date of the overpayment to the date of the demand letter for payment of the penalty? What would be the basis for the interest computation?

6. Is it true that the FAR interest clause (52.232-17) would apply to the penalty, and that the penalty would bear simple interest from the date due until paid unless paid within 30 days of becoming due?

7. If a portion of the disallowed costs was paid to the contractor, and interest computed from the date of overpayment to the date of the demand letter for payment of the penalty, should the ACO issue a demand letter in accordance with 32.610(b) for recovery of these disallowed costs plus interest?

8. If a demand letter for paid unallowable costs is issued in accordance with FAR 32.610(b), would interest computed through the date of the demand letter for the penalty per 231.7002-4(c) resume accruing on amounts not paid within 30 days from the date of the demand?

Please provide a response within 45 days of the date of this memorandum. Ms. Suzanne Servis or Mr. Michael DiRenzo of my staff may be reached at 604-9604 if you need additional information on this request.



Barbara F. Webster
Deputy Assistant Inspector General
Contract Audit Followup



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000



DP/CPF

April 11, 1995

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL,
CONTRACT AUDIT FOLLOWUP

SUBJECT : Assessment of Penalties and Interest for
Unallowable Costs

The following responses are provided to the specific questions contained in your subject memorandum of **February 22, 1995**:

1. The penalty described in **DFARS 231.7002-1(a)(1)** is the **sum** of two amounts: "(i) The **amount** of the disallowed costs allocated to contracts that are subject to this Subpart for which an indirect cost proposal has been submitted, plus (ii) Interest on the paid portion, if any, of the **disallowance**." It is important to understand that (i) and (ii) are components of a **single** penalty amount, and are not separate penalties.

2. The cognizant ACO may **not** waive just the disallowed cost component or the interest component, respectively, of the **DFARS 231.7002-1(a)(1)** penalty. The total penalty amount must be waived or assessed, as the particular circumstances dictate.

3(a). The calculation of any interest component to be included in an unallowable cost penalty is entirely independent from the calculation of any interest due on overpayments to a contractor as the result of a **CAS** noncompliance. If required, each is to be calculated separately.

For example, **CAS 405** unallowable costs contained only in billing rates would trigger the **CAS 9903.201-4/FAR 30.602-2** provision for recovery with interest, but would not trigger the **DFARS 231.70** penalty provision. Conversely, unallowable contained **only** in a contractor's certified indirect cost proposal would trigger the penalty provision but, since no overpayments occurred, recovery with interest under the **CAS** clause would **not** apply.

Consequently, calculation of the interest component for an unallowable cost-penalty clearly is independent of any calculation of interest due as a result of a **CAS** noncompliance.

Enclosure 2



3(b). There is no conflict between the CAS and the DFARS " 231.70 requirements. Therefore, in an unusual case, an ACO may need to follow both sets of requirements. However, it should be noted that the unallowable cost penalties only apply to final indirect cost rate proposals, and not to-proposals, billing rates, or claims.

Under all circumstances, however, a particular provision in the CAS clause must be observed:

In no case shall the Government recover costs greater than the increased cost to the Government, in the aggregate, on the relevant contracts subject to the price adjustment, unless the contractor made a change in its cost accounting practices of which it was aware or should have been aware at the time of price negotiations and which it failed to disclose to the Government.

That language precludes recovery of the overpayment amount more than once and DFARS 231.70 should not be interpreted otherwise.

3(c). Any CAS 405 noncompliance cost impact, including any interest on that impact, would be in addition to any penalty assessed under DFARS 231.70. Again, it is important to understand that any interest component calculated under DFARS 231.7002-1(a)(1) (ii) becomes an integral part of the penalty assessed-

4. Unless a waiver is granted pursuant to DFARS 231.7002-5, the cognizant ACO is required by DFARS 231.7002-3(c) to issue a final decision which includes a demand for payment of any penalty assessed. Contractor agreement with the amount of the penalty would not change this requirement.

5. Pursuant to DFARS 231.7002-4(c), any interest component of the DFARS 231.7002-1(a) (1) penalty is to be computed "from the date of overpayment to the date of the demand letter for payment of the penalty." Accordingly, the interest component (if any) of the penalty cannot be computed until the mandatory demand letter is issued by the cognizant ACO.

6. The FAR interest clause (52.232-17) would apply to any penalty assessed pursuant to DFARS 231.7002-1(a) (1) or (2); and that penalty would bear simple interest from the date due until paid, unless paid within 30 days of becoming due.

7. DFARS 231.7002-3(c) states: "Demanding payment of the penalty is separate from demanding repayment of any paid portion of the disallowed cost." Accordingly, the cognizant ACO may be required to issue a FAR 32.610(b) demand letter for any paid

portion of the disallowed costs, in addition to a demand letter for payment of the unallowable cost penalty.

8. Pursuant to FAR 32.610(b) (2), interest would accrue on amounts not paid within 30 days of the date of any demand letters issued either for the unallowable cost penalty or for any paid portion of the disallowed costs.

We hope this information is helpful. Additional questions may be directed to Mr. Christopher Werner, 695-9764, of my staff.

A handwritten signature in cursive script that reads "Carol Covey". The signature is written in black ink and is positioned above the printed name and title.

Carol F. Covey
Deputy Director
Cost, Pricing, & Finance